THE EUROPEAN PRIVATE COMPANY: DO WE NEED ANOTHER 28TH PRIVATE COMPANY LAW FORM IN THE EU? ON REGULATORY COMPETITION OF CORPORATE LAW

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Abstract

Small and medium-sized enterprises (SMEs) are of vital importance for employment, innovation and growth in the EU member states. However, so far only a rather small number participates in international business activities. The European private company is intended to support SMEs' internationalization. In this paper we analyse whether such an additional supranational legal form is necessary. In a first step we show that from the normative point of view of interjurisdictional competition arguments from welfare economics, public choice and evolutionary economics are mainly in favour of it. In a next step we ask from a positive point of view whether it is nevertheless necessary at all. We discuss to what extent horizontal competition on legal forms is already working within the EU. We find that there is some competition taking place, however, so far it does not address specifically the needs of SMEs when doing business internationally.

Keywords: corporate law, internationalization of small and medium-sized enterprises, regulatory competition, European integration

JEL Classification: F15, H77, K22

1. Introdcution

With the pending passing of the regulation on the European Private Company (EPC) finally, also for SMEs a supranational EU corporate law form could be available some day (EU Council 2011). The EPC would complete the available set of EU legal forms, consisting to date of the European Company, the European Economic Interest Grouping and the European Corporative Society (Fleischer 2010). It thus would fill the gap still open in that so far there is no supranational EU legal form available which is tailored especially to the needs of small and medium-sized enterprises (SMEs).

According to the classification of the EU Commission (EU Com 2003), a company is called a SME, if it meets one of the following three criteria: up to 250 employees, a turnover of not more than 50 mio € a year or its balance sheet totaling up to 43 mio € a year. Given this definition, 99.8% of all 20 mio EU companies are SMEs, employing 65% of the EU workforce and contributing to 58% of the gross value added per year (own calculation according to Wymenga 2011).

About 40% of SMEs are involved in some form of international business activity, be it import, export or foreign direct investment (EU Com 2010a, 46). On average

about 2% of all EU SMEs invest abroad, which amounts to around 500.000 enterprises (EU Com 2010a, 10). In general, SMEs from smaller member states are more internationalized than SMEs from lager member states. If asked what the main barriers to internationalization are, both internal and external obstacles are identified, with high costs of internationalization and lack of capital, adequate information and adequate public support as the most prominent ones (EU Com 2010a, 8). Taking the structural characteristics of SMEs into account, this comes to no surprise (EU Com 2011; Mugler 1999). Problems in gaining access to finance and scarce resources both in human and financial capital due to their size enhance the difficulties to acquire the necessary information to successfully enter foreign markets and thus to realise the gains from larger markets and increased specialization and division of labour.

SMEs in the EU do clearly favour limited liability corporate forms. 50% of all SMEs are private limited enterprises, with additional 9% even being public limited enterprises (EU Com 2010b). This is even more pronounced when looking at those 2% which are engaged in foreign direct investment. Among these, 68% are incorporated as private limited companies and 19.5% as public limited companies (own calculation according to EU Com 2009).[1]

An internationalization friendly corporate law form for SMEs should fulfill the following three criteria: It should (1) be inexpensive, involving low transaction and coordination costs, (2) provide secure property rights for its shareholders and (3) reduce information asymmetries and mitigate agency conflicts between its different constituencies (shareholders, managers, employees, creditors, related parties) (Eckardt 2012, Knoth 2008, Kraakman et al. 2009). It can be shown that the draft regulation of the European Private Company does broadly meet these criteria (Eckardt 2012). The question, however, is whether this is a problem at all. Do we really need another 28th (!) private legal form in the EU in addition to the already existing 27 from each member state?

Until quite recently, company law was largely confined to the member state where a company incorporated. There was neither free movement of legal persons nor free choice of law from different member states. A company doing business in another member state had either the choice of establishing a branch there or of setting up a new company according to the corporate law of the host member state. In the first case, the home company is directly liable for the branch, increasing the risk from doing business internationally. In the second case, additional costs have to be incurred due to the foreign law system, involving additional uncertainty as to the implications of a foreign law form and legal adjudication as well.

However, following its *Centros* decision in 1999 the European Court of Justice (ECJ) has opened up national boundaries in regard to free choice of company law to

[1] For more on the relation between internationalization of SMEs and corporate law form see Eckardt (2012).

a large degree.[2] It is now widely held, that this comes close to having a common market in the EU also in regard to legal forms. Following this, a number of scholars argued that no additional forms of supranational EU corporate law are necessary, since the jurisdiction of the ECJ has opened the way for horizontal regulatory competition (Armour 2005, Gelter 2008/2005, Kirchner/Painter/Kaal 2005, Scharper 2012). Although it would not result in the same outcome as regulatory competition on public limited corporate law forms in the US, where it has a long tradition, there should be incentives strong enough to induce member states to implement new or to modify existing corporate law forms so as to better meet the needs of the actors involved – so the main argument.

With the EPC draft regulation pending, in this paper we turn to these issues again. As the EU is a multi-layered jurisdiction, firstly, we discuss in *section 2* what arguments support a supranational supply of corporate law forms from the normative point of view of interjurisdictional competition. In *section 3* we then ask from a positive point of view whether such an additional supranational private legal form is necessary at all. We analyse to what extent horizontal regulatory competition on legal forms is already working within the EU. *Section 4* concludes by summarizing our main findings and by giving an outlook on open research questions.

2. Supranational EU Legal forms – the Normative View

Within the framework of the theory of interjurisdictional competition a number of criteria have been derived for the assignment of competencies to either the central or lower levels of multi-layered jurisdictions. In the following we discuss whether these criteria are in favour or against a supranational private limited liability corporate law form like the EPC in the EU. We distinguish between arguments from welfare economics, political economics and evolutionary economics, as *table 2.1* shows (Eckardt 2007 and Kerber/Eckardt 2007 with additional references).

The focus of *Welfare Economics* is on the efficient allocation of scarce resources. Thus, the main function attributed to interjurisdictional competition is that of coordinating independent economic activities so as to achieve this objective. The main justification for assigning competencies to a more central jurisdictional level then is to prevent and limit market failure because of the ensuing inefficiencies. While the presence of heterogeneous preferences of the economic actors is the main argument in favour of decentralized competence assignment, market failure arguments like externalities, incomplete and asymmetric information (resulting in additional information and transaction costs), and economies of scale (allowing for market power and strategic behaviour) support a centralized solution. Besides,

[2] See Centros Ltd v Erhevervs- og Selskabsstyreisen (Case C-212/97) [1999] ECR 1459, as well as *Überseering* 2002 (Überseering BV v Nordic Construction Company Baumanagmeent GmbH (Case C-208/00) [2002] ECR 9919 and *Inspire Art* 2003. For an overview of the more recent restrictive rulings of the ECJ see Korom/ Metzinger (2009), Scharper (2012).

bringing about a common playing field also is a strong argument in favour of a centralized assignment of competencies.

In regard to these efficiency considerations, the arguments in favour of the presence of a EU-wide uniform limited-liability corporate law form for SMEs apply to the EPC. With such a supranational legal form, incomplete information diminishes and transaction costs are reduced. Economies of scale and scope imply additional cost reductions if SMEs intend to do business in several member states and adopt the EPC corporate law form for establishing more than one independent subsidiary. Accordingly, market access to several EU member states becomes less expensive, too. Besides, founding establishments in other EU member states becomes accessible more easily for SMEs, since with a uniform corporate law form obstacles of entering foreign markets are reduced and a more equal playing field emerges.

In contrast to that the main point against the EPC are heterogeneous preferences of SMEs' owners on what corporate law form to adopt. However, since the EPC is not the only corporate law form available, entrepreneurs can still chose among the broad variety of the 27 (!) other EU private limited-liability corporate law forms plus other corporate forms available (like partnership or sole proprietor). Accordingly, the EPC does not reduce the choice set available, but on the contrary, it increases it.

Table 2.1. Criteria for vertical assignment of competencies

	Welfare Economics	**Public Choice**	**Evolutionary Economics**
Focus	Efficiency	Distribution	Innovations
Main function of competition	Coordination	Control	Discovery
Objective of competence assignment	to prevent and limit market failure	to prevent and limit political failure	to promote innovation and imitation
Arguments for decentralisation	• Heterogeneous preferences	• Preventing rent-seeking • Political information costs • Economies on political transaction costs	• Decentralised knowledge about problems and their solutions • Adaptive flexibility
Arguments for centralisation	• Externalities • Economies of Scale • Transaction costs economies • Incomplete information • Strategic behaviour • Level playing-field	• Preventing rent-seeking • Political information costs • Economies on political transaction costs	• Economies in innovation activities • Promotion of innovations and their dissemination • Overcoming reform blockades

Source: Own composition according to Eckardt (2007).

Public Choice approaches of interjurisdictional competition focus primarily on distributional questions. They center on the incentives set for rent-seeking activities and ask what assignment of competences can best control a misuse of market *and* political power. For this it is claimed that the main rules of the game should be provided on the constitutional level. In this way they are out of reach of the players and cannot be manipulated while the game is being played. However, to control for the (mis-)use of political power to the advantage of individual interest groups, there are arguments both in favour and against a decentralized allocation of competencies. On the one hand it is argued that a decentralized allocation of competences reduces political information and transaction costs and ensures a more effective control of rent-seeking behaviour. On the other hand, one has to remember that corporate law sets up the basic constitution of economic entities as legal personalities. Taking this into account, the corporate constitution of companies should be out of reach for the players while the game is being played - like it is the case with political constitutions. This would make up for a level playing-field and create legal certainty and reliability for long-term planning by the economic actors. Accordingly, the public choice approach can be seen as favouring the central provision of corporate legal forms as they withdraw the basic constitutional rules of a corporation from the influence of interested parties.

Finally, *Evolutionary Economics* stresses the importance of competition for the generation and dissemination of innovations. They are based on a number of different approaches, with Hayekian and Schumpeterian notions being most prominent (Kerber/Eckardt 2007). Arguments in favour of a decentralized assignment of competencies refer to its greater adaptive flexibility and to its superior problem-solving capacity due to the resulting advantages in knowledge about the underlying problems and the potential for a more flexible response to newly emerging issues. But there are also arguments in favour of a centralized assignment of competencies. They rely on economies of scale and scope achievable in innovation activities, problems in regard to the promotion and dissemination of innovations which stem from the uncertainties related to innovations and to externalities linked to their diffusion. Besides, innovations might also be hindered by reform blockades, which are preserved by interested parties that fear to realize disadvantages from the innovation under question. In addition, due to the large uncertainties of genuine innovations, a secure framework within which economic activity takes place is of special importance.

In regard to these evolutionary arguments there can be made no clear statement either for or against the provision of corporate law forms at the supranational EU level. However, one has to take into account that the European Private Company is not the only corporate law form available for doing business internationally. In fact, it extends the choices available at the horizontal level at the member states to just another alternative. Accordingly, it indeed competes with all other 27 EU private limited liability corporate law forms plus every other corporate law form available for a certain business.

As a summary we find that all three approaches discussed on the assignment of competencies in multi-layered jurisdictions are in favour of additional supranational European corporate law forms. This is supported by the fact that the EPC does not prevent the other 27 limited liability company forms at the level of the member states from being adopted. Accordingly, since there are additional decentral corporate solutions available, the provision of legal forms at the supranational level does not stand against the decentralization arguments either.

3. Competition among Legal forms – the Positive View

Our discussion so far has shown that from a normative point of view there are no arguments against the introduction of a supranational private legal form. However, this result alone does not imply by itself that there is actually the need for an additional private limited-liability corporate legal form provided by the EU level. Therefore, in the following we ask whether indeed additional gains can be expected from such a 28th law form for SMEs in the EU, in particular given that the companies are already able to choose among 27 different corporate forms. To put it differently: would not horizontal regulatory competition suffice to achieve the desired outcome of a SME-friendly corporate law? To this end in *section 3.1* we first summarize the main arguments on the working of regulatory competition among corporate law forms. In *section 3.2* we look at the empirical evidence available so far on horizontal regulatory competition among the existing 27 private company forms in the EU.

3.1. The Framework of Horizontal Regulatory Competition

Following Armour (2005, 5) regulatory competition takes place, when "national legislators compete to attract firms to operate subject to their laws." For this to happen there must not only be some form of arbitrage available setting incentives for firms to incorporate in that member state which provides the highest net benefits. In addition, member states themselves must realize gains or losses high enough so that they have incentives, too, to modify their company laws so as to attract enterprises for incorporation (for an overview see Scharper 2012).

With this concept in mind, then the question is whether incentives for both firms and states are strong enough so that competition does take place indeed. There are a number of factors discussed in the literature which might reduce incentives (Armour 2005, Gelter 2008, Kirchner/Painter/Kaal 2005). They are mostly derived from the US experience, since there is a longstanding tradition of regulatory corporate competition with the state of Delaware having obtained a quasi monopolistic position in regard to public companies (for an overview see Gelter 2008).

On the side of the *firms*, one has to take into account the following factors lowering incentives to switch to another member state's corporate law form (Kirchner/Painter/Kaal 2005). There are mobility costs, switching costs and transaction costs involved in (re-)incorporating in another member state. These costs might be direct and indirect, pecuniary and non-pecuniary. For example, besides

differences in costs stemming directly from the incorporation procedures, there are also additional information costs for legal advice and services as well as for language services (like translations) when incorporating under a foreign law regime. Besides, there might be costs resulting from differences in the reputation of the state of incorporation which transfers to the legal form it provides. Incomplete and asymmetric information not only about a foreign legal form but about the adjudication system, too, may also reduce firms' incentives to incorporate under a foreign law form. Besides the costs of setting up incorporation, the ongoing costs of complying with a member state's regulatory regime also have to be taken into account (Becht/Mayer/Wagner 2008).

Another potential source of restricting competition results from *intermediaries* like lawyers, specialized in the law of a particular legal system (Armour 2005). Because of fear of loss of revenues and the devaluation of their specific human capital investment in particular legal systems, it is argued that they would rather recommend firms not to incorporate under corporate law forms foreign to them. However, one may as well argue that there is extra profit to be obtained by intermediaries like international law firms that specialize exactly in reducing such information asymmetries.

With respect to *member states*, additional revenues generated by incorporation and lobbying from local lawyers are discussed as the main incentives to engage in legal form competition (Gelter 2008). Since in the EU national franchise taxes are not allowed (like it is the case in Delaware where it constitutes one of the major sources of public revenue) there should be no incentive resulting from this source for member states engaging in competition about corporate law form. Besides, it is also a question whether there will be a group of lawyers strong enough to form an influential interest group in any member state. Only then they will have at least some impact to influence national policy-making in such a way that reforms are made so as to attract additional firms to incorporate in this member state. Besides, a specialized adjudication system experienced in company law is seen as another vital condition for the success of Delaware. However, to provide an effective judicial system for adjudication of corporate law issues implies huge investment and thus additional costs for member states. Referring to the Delaware case again, this – so the argument – should give member states with Common Law systems, like the UK, presumably a competitive advantage in contrast to her Civil Law competitors (Armour 2005, Kirchner/Painter/Kaal 2005).

Despite these factors, which restrict the extent of competition, the main view in the literature is that the jurisdiction of the ECJ has not only remove legal barriers for regulatory competition, but that the incentives both from supply and demand side will be strong enough for horizontal regulatory competition to actually taking place (Armour 2005. Gelter 2008). Moreover, the mere threat of intervening by a higher level jurisdiction should suffice so that lower level jurisdictions will modify their corporate law. Accordingly, potential vertical competition through the supranational EU level should also attribute to intensify competition among member states (Gelter 2008, 41ff., Roe 2003, Röpke/ Heine 2005).

Therefore, the question arises as to the direction of such regulatory competition, and in particular whether it might result in a "race-to-the-bottom" or in a "race-to-the-top". There is a hot debate in the US about whether the quasi monopolistic position of Delaware in regard to public corporate law is a sign of either its efficiency or, quite on the contrary, of the deficiencies of the competitive process. But even in the US with its long experience with corporate law competition, no US state has gained a dominant position in regard to private limited company law – as compared to public limited company law (Gelter 2008, 29, Kahan/ Kamar 2001, 2002/2003). In regard to the EU, the opinion is prevailing that due to the strong differences among member states, no "one-size-fits-all" solution to corporate law form will evolve, thus leaving scope for heterogeneity and specialization (Armour 2005, Gelter 2008).

3.2. The Empirical Evidence

So far, there are only few empirical studies on horizontal regulatory competition with regard to limited liability companies. In the following we first provide some data on EU member states and recent reform activities, following the ECJ's *Centros* decision in 1999, before discussing the econometric evidence available.

Since incorporation costs are seen as a decisive factor for companies when deciding on where to incorporate, *table 3.1* shows the minimum shares required in the EU-27 for setting up a limited liability company. Still, there is a broad span, ranging from 1 € in some countries to 35,000 € in Austria. But as *table 3.1* also reveals, since 2003 the minimum share requirements were lowered in 10 of the EU-27 member states, with a reform in Austria being on the political agenda. In addition, Germany and Belgium introduced two special limited corporate forms for start-ups, where the standard minimum share required for incorporation is just 1 €, but has to be raised to that of the standard private legal form of the respective country within the first few years of its operation. All in all, the reductions in minimum shares required can be said to be substantial, ranging from 35% to 100%.

Times spend on activities necessary to incorporate in a country and the costs associated with these have also decreased over the last years. The data collected by the EU Commission presented in *table 3.2* show that this was the case in 18 resp. in 15 of the member states. Between 2007 and 2011 the reduction amounts on average to 15% in regard to costs resp. to 5% in respect to the time necessary for completing incorporation.

This decrease in time and costs for starting a business becomes even more pronounced when looking at the more comprehensive World Bank data in *table 3.3*. They show that between 2004 and 2011 the procedures required as well as time, costs and paid-in minimum share requirements (the latter two as percentage of income per capita) for starting a business decreased on average by about 45%. And indeed, according to these data member states with higher costs for starting a business took more efforts to reduce the burdens for companies to start business than those with lower costs.

Table 3.1. Minimum shares required for limited liability companies in the E-27 (2012)

	Minimum share required (MSR)	Reform	Date	MSR before reduction	Reduction of MSR	Reduc-tion of MSR in %
AT	35 000 €	reduction of MSR introduction of special limited	on the agenda			
BE	18 550 €	company	01.06.2011	1€ (1)	18 549 €	100
BG*	2 556 €					
CY	1 €	reduction of MSR		2 €	2 €	
CZ*	8 133 €					
DE	25 000 €	introduction of special limited company	23.10.2008	1 € (1)	25 000 €	100
DK*	10 737 €	reduction of MSR	12.06.2009	16 777 €	6 040 €	36
EE	2 500 €					
EL	4 500 €	Reduction of MSR		18 000 €	13 500 €	75
ES	3 000 €					
FI	2 500 €	reduction of MSR	01.06.2006	8 000 €	5 500 €	69
FR	1 €	reduction of MSR	01.08.2003	7 500 €	7 500 €	100
HU*	1 790 €	Reduction of MSR	15.06.2007	10 738 €	8 948 €	83
IE	1 €					
IT	10 000 €					
LT*	2 896 €					
LU	12 395 €					
LV*	2 822 €					
MT	1 165 €					
NL	18 000 €					
PL*	1 213 €	Reduction of MSR	23.10.2008	12 134 €	10 921 €	90
PT	1 €	Reduction of MSR	07.03.2011	5 000 €	4 999 €	100
RO*	47 €					
SE*	5 537 €	Reduction of MSR	01.04.2010	11 074 €	5 537 €	50
SI	7 500 €					
SK	5 000 €					
UK*	1 €	Reduction of MSR		2 €	2 €	
Mean	**6 698 €**			**Sum**	**106 498 €**	
				Mean	**8 875 €**	

*) exchange rate 2011 according to ECB

(1) but: increase to the minimum share required of the standard private company form within the first few years of operation

Source: According to German Trade and Invest (2012), Becht/Mayer/Wagner (2008), Braun et al. (2011).

Table 3.2. Costs and time required for start-ups in the EU-27 (2007-2011)

Member state	Costs in €		Time in days	
	2007	**2011**	**2007**	**2011**
AT	400	385	18.5	11
BE	517	517	1.5	1.5
BG	155	56	21.0	5
CY	265	265	7	5
CZ	345	345	49	15
DE	783	226	7	5
DK	0	89	3	1
EE	190	185	2	2
EL	1366	910	30	5
ES	617	115	35	17.5
FI	330	330	14	8
FR	84	84	4	4
HU	392	392	2.5	2
IE	50	50	3.5	3.5
IT	2673	2673	4	1
LT	210	209.5	8	4
LU	1000	1000	14	14
LV	205	205	4	4
MT	450	210	8.5	6.5
NL	1040	1040	3	2
PL	735	428.5	30	22.5
PT	330	330	1	1
RO	112.5	113	3	3
SE	222	185	21	16
SI	250		3	3
SK	330	335	14	12
UK	54	33	1	6
Mean	**485**	**412**	**83**	**78**
Change in %		**-15**		**-5**

Source: According to EU Commission (2010c) with own calculations.

Table 3.3. Starting a Business in the EU-27 (2004-2011)

	Procedures (number)		Time (days)		Costs (% of income per capita)		Paid-in Min. Capital (% of income per capita)	
	2004	**2011**	**2004**	**2011**	**2004**	**2011**	**2004**	**2011**
AT	8	8	28	28	6.1	5.2	65.6	52
BE	7	3	56	4	11.1	5.2	24.1	18.9
BG	11	4	32	18	10.4	1.5	86.7	0
CY	..	6	..	8	..	13.1	..	0
CZ	10	9	40	20	10	8.4	47.4	30.7
DK	5	4	7	6	0	0	49.8	25
EE	6	5	72	7	8	1.8	53	24.4
FI	3	3	31	14	1.1	1	29.8	7.3
FR	8	5	41	7	1.3	0.9	29.2	0
DE	9	9	45	15	5.9	4.6	49.1	0
ES	15	10	38	10	32.7	20.1	135.2	22.8
HU	6	4	52	4	40.4	7.6	96.4	9.7
IE	4	4	18	13	10.4	0.4	0	0
IT	9	6	23	6	22.1	18.2	11.6	9.9
LV	5	4	16	16	10.1	2.6	45	0
LT	8	6	26	22	4	2.8	68	35.7
LU	..	6	..	19	..	1.9	..	21.2
MT	..	..	..	..	..	..	..	..
NL	7	6	9	8	13.3	5.5	67.2	50.4
PL	10	6	31	32	21.2	17.3	247.4	14
PT	11	5	78	5	12	2.3	40.4	0
RO	6	6	29	14	10.9	3	2.9	0.8
SK	10	6	103	18	9.4	1.8	50.3	20.9
SI	9	2	60	6	14.8	0	19.9	43.6
ES	10	10	114	28	16.8	4.7	17.9	13.2
SE	3	3	15	15	0.7	0.6	38.5	14
UK	6	6	13	13	1	0.7	0	0
Mean	**6.9**	**5.4**	**36.2**	**13.2**	**10.1**	**4.9**	**47.2**	**15.4**
Change %		**-21.5**		**-43.7**		**-43.5**		**-44.9**

Source: According to World Bank (2005, 2012) with own calculations.

Unfortunately, to date there are no comprehensive data available to analyze the degree of mobility firms exercise in response to the reform efforts of member states. However, an indicator of the reagibility of firms to changes in supply of legal forms can be found in the German *Gewerberegister* (Trade register). Since 2005 it separately provides figures for firms incorporated as British Private Company Limited by Shares registered in Germany. *Table 3.4* below shows all businesses newly registered resp. deregistered in Germany from 2005 to 2011 which are either incorporated as a *Gesellschaft mit beschränkter Haftung* (GmbH), the "German" private company, or as a *British Private Company Limited by Shares* (UK-Limited). On average, between 2005 and 2011 each year 5,201 companies registered as a *UK-Limited* in Germany. In 2006 there was the highest share with 11% of all newly registered *GmbH*s. However, since 2007 there is a sharp decline in the registration of newly registered *UK-Limited*s of about 27% each year.

This development can be attributed to the reform of the German limited liability law. In 2008 an additional limited company form was introduced, the *Unternehmergesellschaft* (UG) (see *table 3.1*). The minimum share required is just 1 €, but companies are obliged to increase minimum capital to the standard minimum share required for a *GmbH* over time. As can be seen from *table 3.4* the number of newly registered *GmbH* increased by 15% in 2009 compared to 2008, while being rather stable since then. 17% of all newly registered companies incorporated as a *UG* in 2011.

These figures are in accordance with the findings of Becht/Mayer/Wagner (2008) as well as Hornuf (2011) and Braun et al. (2011). They provide additional evidence that there is horizontal competition on corporate law forms taking place in the EU, however, this is related mostly to start-ups.

Becht/Mayer/Wagner (2008) analyse the impact of the ECJ's *Centros* and forth following decisions regarding freedom of establishment for national corporate law forms in the EU for companies' incorporation decisions. They test whether the resulting deregulation has any impact at all on companies' decision on where to incorporate. To this end the authors use a data set of all limited liability companies newly established in the UK between 1997 and 2005, based on the UK central business register. With the information available there, they distinguishing between *domestic Limited*s and *non-domestic Limited*s**,** the latter being companies which are incorporated under UK company law as British *Limited*s, but are intended to have their principal place of business outside the UK. As a proxy for classifying such *non-domestic Limited*s, they use the state of residence of a company's directors. In this way they get a sample of 2.14 mio. limited liability companies, with 78,000 *non-domestic* firms incorporated between 1997 and 2005, of which one third being a *German Limited*, that is having directors residing in Germany. Applying different econometric tests they find that following the ECJ's *Centros* decision there was a significantly stronger inflow of incorporations from other EU member states than from non-EU member states in the UK. Besides, incorporation from EU member states with high costs of setting up a business, particularly in respect to minimum shares required, were significantly higher. According to their findings, already small differences in minimum shares required for setting up a private company induced

mainly small companies to incorporate in the UK. Taking this into account, they argue that reductions in minimum shares required in EU member states should lead to a decrease in the number of *non-domestic Limiteds* incorporating in the UK. All in all, Becht/Mayer/Wagner (2008) hold horizontal regulatory competition in regard to corporate law form to be working in the EU.

Table 3.4. GmbH and Private Company Limited by Shares in Germany (2005-2011)

Gesellschaft mit beschränkter Haftung (GmbH)

				change p.a. (in %)	
year	**newly registered companies**	**deregistered companies**	**net total**	**newly registered companies**	**companies deregistered**
2005	81 415	70 605	10 810		
2006	77 530	67 490	10 040	- 5	- 4
2007	80 277	63 096	17 181	4	- 7
2008	82 533	65 035	17 498	3	3
2009	94 961	70 580	24 381	15	9
2010	95 481	68 500	26 981	1	- 3
2011	91 610	66 251	25 359	- 4	- 3
mean	**86 258**	**67 365**	**18 893**	**2**	**- 1**
2011-UG (1)	**15 423**	**5 103**	**10 320**		
share of GmbH (%)	**17**				

Private Company Limited by Shares

				change p.a. (in %)	
year	**newly registered companies**	**deregistered companies**	**net total**	**newly registered companies**	**companies deregistered**
2005	6 625	1 814	4 811		
2006	8 643	3 166	5 477	30	75
2007	7 463	4 243	3 220	-14	34
2008	5 863	4 568	1 295	-21	8
2009	3 632	4 916	- 1 284	-38	8
2010	2 486	4 531	- 2 045	-32	-8
2011	1 693	3 336	- 1 643	-32	-26
mean	**5 201**	**3 796**	**1 404**	**- 18**	**15**

(1) UG = Unternehmergesellschaft

Total number of businesses: 3.6 mio in 2009 (source: Unternehmensregister, Statistisches Bundesamt)

Source: Statistisches Bundesamt (different years).

Hornulf (2011) and Braun et al. (2011) confirm these findings. They also use a difference-in-difference approach to analyse the causal impact resulting from reforms in statutory laws concerning minimum share requirements in France, Germany, Hungary, Poland and Spain between 2003 and 2008. Applying the same methodology as Becht/Mayer/Wagner (2008) they find an increase in incorporations as well as start-ups in general in the respective countries following the reduction in minimum share requirement costs.

In line with these findings that incorporation costs matter, although using a different methodology, is Häusermann (2011). He analyses the impact of differences in incorporations fees for limited liability companies as compared to corporations for state-level data in the USA from 2004 to 2009 using OLS. He finds that differences in fees significantly affect the popularity of the numbers of limited liability companies found in a state.

Whereas the studies above take into account the impact of incorporation costs on the decision of companies of where to incorporate, there are also some first studies which analyse for the US whether variation in substantive law and in legal infrastructure and judicial quality have an impact on company's incorporation decisions.[3] Dammann/Schündeln (2008, 2010) and Kobayashi/Ribstein (2011) use a subset of limited liability companies in the US, concerning the years 2006 resp. 2008. Their descriptive statistics show that Delaware is the state which attracts most of foreign companies for incorporation – as it is the case in regard to publicly held companies. To estimate the impact of a number of independent firm- and state-level variables on the probability whether a company is formed in the state where it has its primary place of business or not, they use probit regressions. They find clear evidence that firm size matters, in that bigger companies show a higher probability to form outside the state where they have their primary place of business. However, there is contradicting evidence on the impact of variables regarding substantive rules, like protecting minority shareholders, or the quality of the judiciary. While Dammann/Schündeln (2008, 2010) find that higher standards of minority shareholder protection attract outside companies to incorporate in a state, Kobayashi/Ribstein (2011) find no statistically significant effects. As Gevurtz (2012) discusses that this might well result from omitted variable bias.

Gevurtz (2012) himself performs a qualitative analysis based on 50 interviews with private attorneys on the motives companies have when choosing a state for incorporation different from their principal business location. He finds that Delaware is chosen due to its superior legal infrastructure and that it has advantages in the eyes of majority owners or managers of limited liability companies. Despite its high market share in regard also to the incorporation of non-domestic limited liability companies, Manesh (2011) shows that Delaware holds no monopoly in this market

[3] For the US there is also a broader empirical literature on the working of regulatory competition in regard to public held companies, see Kobayashi/Ribstein (2011) with additional references.

as it does in the US charter market for public corporations. Accordingly, it cannot demand a monopoly franchise fee for limited liability companies.

Both the descriptive data and the findings of the econometric studies discussed provide evidence that there is horizontal competition on the limited liability corporate law form taking place in the EU and the US. *Firms* react to changes in minimum share requirements by member states. Cost differences do influence their decision on where to incorporate. However, this holds primarily for newly founded companies. No empirical studies are available to date on the choices of legal forms of different member states by already established firms neither is there evidence in regard to SMEs doing business internationally.

Intermediaries play an important role for both market sides, too. As Becht/Mayer/Wagner (2008) already stated, EU-wide operating law firms contribute in promoting foreign corporate law forms and reducing information and transaction costs for firms to a large degree. The same might hold true in regard to member states' reform activities. The EU Commission is an important actor in monitoring member states in improving their business environment for start ups.

Member states respond to the migration of firms to other countries, too, however slowly. While the jurisdiction of the ECJ introduced freedom of establishment for corporate law form with its rulings following its *Centros* decision in 1999, it took *member states* some years to implement reforms of their company law. It nevertheless provided on average profound reductions of the minimum shares required. These findings, however, imply that incentives for member states to react to firms' incorporation decisions are somehow inconclusive. In some countries mobility of firms in incorporating in other states has been clearly stated as a main reason for modifying the existing domestic company law, while slow or no reaction at all has taken place in other countries. Besides, in regard to other factors influencing companies' incorporation decisions not that much of reform activity seems to be exerted by the threat of firms to migrate to another jurisdiction. This is confirmed by the findings of the recent research on horizontal competition regarding limited liability companies in the US discussed above. So far, it is quite still rather unclear what incentives states have to engage in regulatory competition and what causes firms to select their preferred state of incorporation.

All in all, the available empirical findings do not indicate that the ongoing horizontal competition is in favour of the evolution of internationalization friendly legal forms for SMEs in the EU. Accordingly, it does not exclude *per se* the introduction of an additional supranational form like the European Private Company.

4. Conclusions

What conclusions can we draw from our discussions above on the introduction of the European Private Company? In *section 2* we showed that neither welfare economics nor public choice nor evolutionary economics provide overall arguments against the introduction of a supranational legal form in the EU that supplements the

already existing company forms. In *section 3* we found evidence that in deed there is horizontal regulatory competition on company law working in the EU. However, so far no clear-cut conclusions in regard to the implementation of supranational legal forms can be drawn from this. In particular, there is no evidence available on whether changes in company law are directed to better address the needs of SMEs for internationalizing. The data provided above give only hints that firms do react to cost differences. But there are no indicators available as to whether for example the newly introduced German *Unternehmergesellschaft* is used specially for internationalization of SMEs. For example, it would allow German SMEs to set up a separate company by incorporating in Germany, while registering it and doing business in another country. In doing this, at least some of the costs of incorporating under a foreign law regime could be saved.

To improve our knowledge on these issues, additional research is required. Since the empirical evidence so far is rather descriptive and limited to a small sample of cases, follow-up studies to that of Becht/Mayer/Wagner (2008), Hornuf (2010) and Braun et al. (2011) are desirable. Moreover, additional qualitative and quantitative studies on the supply and demand side of horizontal regulatory competition in the EU are necessary. For one thing, there are only first hypotheses as to the variables influencing *SMEs'* decisions on whether to incorporate in a foreign jurisdiction or use a domestic legal form when going international. This comes to no surprise as it is of only a very recent nature that choice among legal forms from different countries has become another variable to be controlled for by firms themselves. Since choice of foreign company law is affected with huge information asymmetries, *intermediaries* play an important role as match-makers. An EU-wide market for advice on these issues is already emerging. Internationally active law firms and business advisors might provide expert information both on the critical issues in regard to company law choice as well as a source for quantitative analysis. Finally, in-depth comparative studies of national company law reforms might provide necessary insights for forming and finally testing hypotheses as to the incentives of *countries* to actively engage in regulatory competition on company regimes.

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